



The Commonwealth of Massachusetts
Department of Public Utilities
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June 12, 1997

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, D.C. 20515

RE: Questions on Electric Industry Restructuring

Dear Mr. Dingell:

Enclosed please find answers to the questions posed in your letter dated April 10, 1997 concerning the question of whether or not the Congress should enact legislation concerning the electricity industry.

1. **Q. Has your Commission or state legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices?**

A. Our commission has considered retail competition and has stated that we intend to take all steps possible within our jurisdiction to bring the benefits of retail choice and competition to Massachusetts electricity consumers on January 1, 1998. We issued a plan proposing retail competition with accompanying draft legislation and model rules in Electric Industry Restructuring, D.P.U. 96-100 (1996). The legislature is also considering proposed legislation that would offer retail choice to electricity consumers. To date, there has been no immediate effect on consumer prices.

2. **Q. Has your state asked Congress to enact legislation mandating retail competition? Has it sought Congressional action to enable or assist it in adopting retail competition? Has it requested or recommended any other type of Congressional action?**

A. We have not asked for federal legislation mandating retail competition; but we have indicated that there are areas that require federal attention. In two areas, transmission and environmental regulation, the need for federal action is particularly urgent. First, the Federal Energy Regulatory Commission ("FERC") must continue and complete its efforts to ensure the development of a fair, open and non-discriminatory framework for high-voltage transmission service. This process will require the creation of new rules and institutions that will support the development of efficient regional markets. It may be necessary for Congress to clarify the FERC's authority in order to bolster the agency's important efforts. Second, federal action may be appropriate to ensure that restructuring of the electric industry does not come at the expense of the degradation of the environment, but instead leads to a "win-win" outcome for the nation's economy and its environment.

3. **Q. Does your Commission currently have sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address any such problems?**

A. We have asked our legislature for explicit authority to establish stranded cost recovery rules; however we have not yet been granted that authority. If Congress were to enact a law mandating retail competition by a date certain which limited the recovery of a utility's stranded costs, utilities would be placed under duress and, conceivably could be forced into bankruptcy under Federal Accounting Standards Board rules. Congress should not mandate retail competition by a date certain without including some provision allowing states to address the stranded cost issue in a timely fashion.

In addition, Congress should authorize state commissions to impose access charges on the retail delivery of electricity to recover stranded costs and to fund public benefits and Congress should confirm that states have exclusive authority over the recovery of all retail stranded costs. Furthermore, Congress should prohibit customers from escaping retail stranded cost obligations by bypassing local distribution facilities. See Comments of National Association of Regulatory Utility Commissioners, May 28, 1997.

4. **Q. Are there any other areas in which your state currently does not have the necessary authority to address issues arising from federal legislation mandating competition, or repeal of the Public Utility Holding Company Act of 1935 (PUHCA) or the Public Utility Regulatory Policies Act of 1978?**

A. At present, public utilities comply with the Public Utility Holding Company Act of 1935 and the Public Utility Regulatory Policies Act of 1978. In addition, public utility commissions, including the Massachusetts DPU, have promulgated regulations

consistent with PURPA requirements. As long as PUHCA and PURPA are not repealed, states cannot pass legislation that would contradict their requirements.

PUHCA will continue to limit the number of generators of electricity by subjecting these entities to comprehensive regulation. Therefore, one aspect of the restructuring of the electric industry should be PUHCA reform. Any PUHCA reform should provide states with the ability to obtain access to utility books and records relevant to rates and conditions of service of utility ratepayers, should preserve the holding company diversification standards recently enacted in the Energy Policy Act and the Telecommunications Act, and should not restrict state oversight authority, including the ability to conduct audits and allocate costs, necessary to protect utility consumers that remain captive to a utility affiliate.

With regard to PURPA, depending on the Court's interpretation of the statute, Section 210's mandatory purchase requirement on utilities (at "avoided cost") may be inconsistent with a fully competitive retail generation market. In addition, utilities may no longer be in the business of supplying generation (other than in a default service context). It may be advisable to repeal the Section 210 purchase requirement for states that have made a determination that the acquisition of generating capacity is subject to competition.

5. Q. Would any constitutional issues be raised by federal legislation:

a. mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition?

b. requiring states to conduct a proceeding on retail competition, reserving to the states' discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interests?

A. a and b. Both scenarios may be subject to challenge under the Tenth Amendment to the United States Constitution which states that "the powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or the people." The question is whether Congress can enact legislation requiring states to administer a federal regulatory program, i.e., whether the federal government can constitutionally regulate not private parties, but the states as states.

In addition, under scenario a, constitutional issues could arise in the implementation stage. For example, if the legislation precluded recovery of stranded costs, the utilities would claim that there was an undue taking of private property without just compensation (Takings Clause of the Fifth Amendment to the United States Constitution). Utilities could argue that there

was a physical taking, a regulatory taking or a confiscatory ratesetting, the three categories of takings.

6. Q. From a practical standpoint, what problems would arise if Congress adopted legislation mandating retail competition which did not grandfather prior state action?

A. We suggest that restructuring legislation at the federal level, if any, should accommodate or grandfather any state action that is not substantially inconsistent with the federal legislation. It is important that states which are in the forefront of restructuring the electric industry and are in the process of resolving most of the critical issues be allowed to proceed un-hindered. Federal legislation that led to results contrary to what has already been determined at the state level could prove to be highly disruptive by reopening many of the settled issues. We expect the Massachusetts legislature to enact restructuring legislation in 1997.¹

7. Q. In hearings before the Energy and Power Subcommittee during the last Congress, some witnesses took the position that Congressional legislation mandating retail competition is necessary to protect the interests of small and residential consumers. This was based on the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and that the incidence of such rate reductions is on the increase.

7a. Q. Are you aware of any study or analysis relevant to your state that supports this conclusion?

A. We are aware of no studies that compare the rates of industrial customers to residential customers. However, please find attached a list of the special contracts reviewed by the Department (Attachment I) and letter order D.P.U. 96-39 (1996) (Attachment II), which sets forth our standard of review for special contracts. Although the Department has approved special contracts that lower industrial customers' rates, the Department has not allowed the electric companies to collect any lost revenues from these special contracts from their other customers. Federal legislation is unnecessary to protect small and residential customers in Massachusetts, because existing and proposed commission policy and proposed state legislation and rules will be sufficient.

¹ Governor Weld filed legislation (H.4311) which was drafted by the Department of Public Utilities, the Division of Energy Resources, and the Department of Environmental Protection. In addition, the Massachusetts Special Legislative Committee on Electric Industry Restructuring filed restructuring legislation (S.1714).

7b. Q. Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether or not this trend has altered in recent years.

A. We are aware of no studies that show the historical relationship between residential and industrial rates, and the extent to which one customer class has subsidized another. However, please be aware that one of the Department's objectives in developing rates is to determine an overall revenue requirement for each class that reflects the costs a company incurs to serve that class. See Massachusetts Electric Company, D.P.U. 95-40, at 98-99 (1995). Therefore, although some customer classes are still subsidized, the Department over the past fifteen years has progressively reduced cross-subsidization and moved towards substantially equalized rates of return.

8. Q. Although electricity rates vary within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your state, and how they affect various customer classes.

A. The only information the Department is aware of that shows rate trends is the National Association of Regulatory Utility Commissioners' Residential Electric Bill Survey. This survey provides a comparison of current residential electric bills between electric companies nationally, as well as, to bills from five years ago. Please find attached a copy of the pages from this survey that cover electric companies in Massachusetts (Attachment III).

9. Q. Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers? What mechanisms could states or Congress employ to manage these issues? In a restructured electric industry, who should receive the benefits of these low-cost resources -- utility ratepayers, utility shareholders or the highest bidder?

A. In our proposed restructuring plan we have stated our intention to take actions necessary to promote the development of an efficient competitive market in the electricity generation sector. Although we anticipate that, as a general matter, the transmission and distribution sectors would continue to be regulated, we do not anticipate regulating retail rates for electricity supply (generation) except to maintain certain consumer protections such as the low-income discount. We anticipate that open competition among suppliers, properly structured and monitored, should tend to drive prices lower over time compared to the likely trend of prices under the current system. The benefits of low-cost resources in a market-based system would be widespread as long as all customers have retail choice -- customers would get the

benefits of lower prices, utility shareholders should see improved system utilization, and efficient suppliers would enjoy business opportunities. In addition, we have stated that electric utilities in Massachusetts must mitigate their stranded costs to the maximum extent practicable. To the extent that electric utilities are able to sell their low cost resources in the competitive market for generation, shareholders and customers will benefit from lower stranded costs.

- 10. Q. Of those states which have adopted retail competition, how many have addressed the issue of "reciprocity", (that is, whether or not the state can bar sellers located in states which have not adopted retail competition from access to its retail markets)? Whose interests does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives. Would such a requirement raise constitutional issues?**

A. We have not addressed the issue of reciprocity with regard to out-of-state sellers. We have addressed the issue of reciprocity with regard to municipal light plants. We have said that if a municipal light plant wishes to sell electricity to retail customers outside of its service territory, it would be required to allow other sellers of electricity to sell to the citizens in its municipality. We believe that this policy serves as an incentive for municipal light plants to open their service territories. In general, reciprocity serves the interests of all customers by promoting fair competition and providing incentives for all to open up their markets.

We believe that legislating reciprocity on an interstate basis is unnecessary because, in practice, states that open their markets first will attract lower competitively-priced power, thereby leaving captive ratepayers in non-reciprocating states to pick up the residual costs. This may serve as sufficient incentive to open up all markets in time.

Reciprocity, as a policy, may also raise commerce clause concerns; *i.e.*, by treating certain suppliers (those which are located in states with retail competition) differently from other suppliers (those which are located in states without retail competition). This could be deemed a violation of the free flow of commerce among states.

- 11. Q. If Congress were to require "unbundling" of local distribution company services as part of a retail competition mandate, what practical problems might this present to state regulators?**

A. We have directed the electric utilities in Massachusetts to functionally separate and unbundle their rates into distribution services, transmission services, and generation services. We do not anticipate that such a requirement would pose a problem in this state. In addition, we expect that most, if not all, of the utilities in Massachusetts will agree to divest their generating assets.

Further, Massachusetts has recently addressed the issue of opening certain distribution subfunctions to competition, in particular, metering, billing and information services ("MBIS"). Following the lead set by California, we have invited interested parties to come to a negotiated collaborative resolution of whether MBIS should be made competitive and, if so, what is the best way to achieve this objective.

12. Q. Does your Commission face particular problems in connection with public power or federal power in an increasingly competitive electricity market?

A. A small number of our municipal electric companies obtain a small amount of St. Lawrence preference power, but for the most part Massachusetts does not enjoy the benefits of federal power. We do consider, however, that maintaining a large role for tax-advantaged public power hinders efficient competition among suppliers and places certain regions at a disadvantage relative to others -- in particular, in the Northeast, where the monies lost by our region's taxpayers exceed the benefits enjoyed by our region's electric ratepayers, who are currently paying among the highest rates in the nation.

13. Q. How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems might arise if it were not?

A. We anticipate that the initial transition to competition will require additional resources for our Department. Our governor and legislature appear to agree and to be considering steps to provide increased resources for the transition. If, however, federal legislation imposes significant near-term mandates that are in addition to the restructuring plan and legislation in this state, it could increase our budget needs beyond what is currently anticipated and supportable in the Massachusetts Legislature.

14. Q. Has your Commission considered or adopted securitization plans as a means of providing for the recovery of utility stranded assets? What risks are inherent in this approach, and who bears them?

A. Our Commission did not adopt securitization plans in its December 1996 order on electric industry restructuring; during hearings held in July 1996 there was very little interest expressed on the subject. However, there is proposed legislation in Massachusetts with regard to securitization. On the one hand, the Joint Legislative Committee on Electric Industry Restructuring has filed a bill allowing almost all stranded costs to be securitized (H.1714). On the other hand, the Governor's bill, which has our support, allows securitization of those costs relating to the renegotiation of above-market purchased power contracts.

The Massachusetts Division of Energy Resources ("DOER") has addressed the issue of securitization in "An Analysis of Securitization in the Context of Legislation

Proposed by the Joint Committee on Electric Utility Restructuring" (April 16, 1997) (Attachment IV). DOER states that the overall purpose of securitization is to reduce the utility's cost of capital resulting in a decreased revenue requirement and, therefore, lower rates paid by consumers. However, DOER notes that such savings can be substantially affected by (1) the impact of federal income taxes on the securitization transaction, (2) the accelerated income tax deductions that have already been taken by electric companies on the stranded generation assets sought for securitization, (3) the relatively low cost of existing utility long-term debt relative to the cost of rate reduction bonds, and (4) the existing bond covenant restrictions on utility debt/equity ratios which prevent the replacement of existing utility equity with additional debt.

Regarding the issue of risk, the DOER states that if the securitization program were to allow the securitization of stranded costs associated with owned-generation assets then the investment risks are transferred from the utility investor to the ratepayer, and may force ratepayers to pay twice for the same utility capital -- a premium in excess of market rates of return to compensate utility investors for the risk that generation investments may not be fully recovered, and 100 percent of the above-market cost of utility investments that would not be recovered in a competitive generation market. The full text of the DOER's Analysis is attached to these comments.

15. Q. There is a wide divergence of opinion as to whether or not PUHCA should be modified or repealed. Given the record level of merger activity, this question many become significant for all state regulators, whether or not they currently have regulatory responsibilities relating to registered holding company activities:

15a. Q. Do you believe PUHCA impedes competition, at the wholesale or retail level? Can "effective competition" be achieved regardless of whether Congress enacts changes to PUHCA?

A. PUHCA does impede competition by restricting competition. Presently, many would-be suppliers of electricity will not enter the market for fear of becoming a "utility" under PUHCA and thereby subject to comprehensive regulation. We believe that while PUHCA provides for appropriate ratepayer protections in a monopoly environment, as retail competition is introduced, the rationale for PUHCA diminishes. Nevertheless, we do believe that any changes to PUHCA should protect state interests. See the answer to question number four.

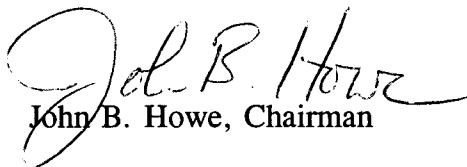
15b. Q. Do you believe Congress should modify or repeal PUHCA? If so, why, and under what, if any, conditions?

A. See the answer to question number four.

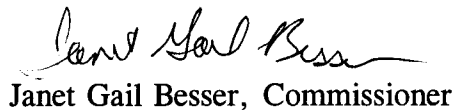
15c. Q. Should Congress enact legislation to modify the holding in Ohio Power Co. v. FERC, 954 F.2d 779 (D.C.Cir. 1992)?

A. Yes. It is important that FERC be allowed to rule on the justness and reasonableness of wholesale rates. All entities, whether affiliates of electric companies or not under PUHCA should bear the risk of market changes, at least prospectively. Therefore, section 13(b) of PUHCA should be amended. New legislation should not preempt state retail rate decisions, including state authority to regulate any affiliate's costs proposed to be passed on to retail customers.

Sincerely,



John B. Howe, Chairman



Janet Gail Besser, Commissioner